DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 01-0312
Adjusted Gross Income Tax – Unitary (Combined) Filing Status
Fiscal Years 1996 through 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Adjusted Gross Income Tax—Nexus

Authority: *Rural Elec. Mem. v. Indiana Dept. of State Revenue*, 733 N.E.2d 44 (Ind.Tax 2000)
IC 6-8.1-9-1(a)
Black's Law Dictionary (7th Ed. 1999)

Taxpayer protests the Department's determination that taxpayer should have filed unitary combined tax returns with its holding company, on the basis that taxpayer does not have the requisite nexus with Indiana to subject taxpayer to the Indiana adjusted gross income tax.

STATEMENT OF FACTS

Taxpayer is a manufacturer and distributor of pharmaceutical products. Although taxpayer has no business location within Indiana and maintains headquarters outside of the state of Indiana, taxpayer does have a resident sales force in Indiana. Taxpayer's resident salespersons generally work from home offices. The salespersons do not give away samples; and, no orders are accepted or approved within Indiana.

In 1990, taxpayer formed a wholly owned Delaware holding company (hereinafter, "Holding Company"). At that time, taxpayer transferred marketing rights to the Holding Company pursuant to an Internal Revenue Code § 351 tax-free exchange for one hundred percent (100%) of the Holding Company's stock. Three thousand (3000) shares of common stock with a par value of one dollar ($1.00) per share were issued. Taxpayer and the Holding Company simultaneously executed a royalty agreement whereby the Holding Company granted an exclusive, irrevocable license of the marketing rights and other intellectual property to the taxpayer in exchange for royalty payments.

The royalty fee was computed based upon a percentage of sales of licensed products sold by the taxpayer. The Holding Company then loaned royalty proceeds at a market rate of interest to taxpayer and other members of the taxpayer's family of companies. Royalty proceeds not loaned to members of taxpayer's family of companies were returned to taxpayer in 1998 in the form of an inter-company dividend that was one hundred percent (100%) eliminated from taxable income.

After review of the audit results, the Department's position was that the business activities of the Holding Company and the taxpayer constituted a unitary business. In addition to finding that taxpayer and the Holding Company enjoyed unity of ownership, operation, and use, the Department further found that the net effect of the inter-company business arrangement was that the large amounts of royalty income reported by the Holding Company, and the corresponding large royalty expense reported by taxpayer reduced the taxable income apportioned to all states in which taxpayer conducted business. Due to this distortion of income, the Department determined that the only way to realistically portray taxpayer's true Indiana income was to require taxpayer to file a unitary combined return with the Holding Company.

Taxpayer disagrees with the Department's determination. According to taxpayer, a review of taxpayer's activities in Indiana renders the Department's unitary determination moot, as the review demonstrates that taxpayer does not have the requisite nexus within the state to subject taxpayer to the Indiana adjusted gross income tax.

Adjusted Gross Income Tax—Nexus

DISCUSSION

In the instant case, the Department determined that taxpayer should have filed unitary combined tax returns with its holding company in order to accurately report taxpayer's Indiana income. Taxpayer asserts that the Department's determination is moot because taxpayer lacks sufficient nexus with the state to subject taxpayer to Indiana's adjusted gross income tax.

Taxpayer raises the nexus argument for the first time in its protest letter dated October 26, 2001. As such, the original audit report does not address this argument. Based upon the circumstances of this case (*i.e.*, taxpayer's raising an argument not addressed in the audit report), it must be determined whether or not taxpayer's protest is ripe for determination.

"Ripeness relates to the degree to which the defined issues in the case are based on actual facts rather than on abstract possibilities, and are capable of being adjudicated on an adequately developed record." *Rural Elec. Mem. v. Indiana Dept. of State Revenue*, 733 N.E.2d 44, 47 (Ind.Tax 2000). According to Black's Law Dictionary, p. 1328 (7^{th} Ed. 1999), ripeness is the "circumstance existing when a case has reached, but has not passed, the point when the facts have developed sufficiently to permit an intelligent and useful decision to be made."

In the instant case, the nexus issue is not ripe for determination. Taxpayer raised the nexus issue after the audit report was completed. Although the audit report provides ample findings regarding whether or not taxpayer should have been required to file unitary tax returns with the Holding

Company, the report does not (because it could not) provide any findings regarding taxpayer's nexus argument. Because of the unique circumstances of this case, the Hearing Officer received a file wherein the facts were insufficient to allow an intelligent decision to be made.

Notwithstanding the above, taxpayer may still preserve its nexus issue. In order to do so, however, taxpayer must pay the current assessment in full and file a claim for refund. By paying the current assessment and filing a claim for refund, taxpayer's claim for refund avoids the bar of statute of limitations. (*See*, IC 6-8.1-9-1(a) which states in relevant part: "If a person has paid more tax than he determines is legally due for a particular taxable period, he may file a claim for refund with the department. In order to obtain the refund, the person must file the claim with the department within three (3) years after the latter of the following: . . . ; (2) the date of payment; . . .")

Once taxpayer pays the assessment and files its claim for refund, the Audit Division will review the claim for refund and make its determination based upon the facts of the case. If taxpayer is not satisfied with the Audit Division's decision regarding taxpayer's claim for refund, taxpayer may file a protest requesting a hearing before a Hearing Officer for the Department.

FINDING

Taxpayer's protest is denied. However, if taxpayer would like to preserve its nexus argument, taxpayer should, in accordance with this Letter of Findings, pay the assessment in full and file a claim for refund..

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